No. 13,039

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association, and EUGENE J. O'RILEY, as Trustee in Bankruptcy of the Estate of United Produce Company, a corporation, Bankrupt,

Appellants,

vs.

MERCHANDISE NATIONAL BANK OF CHICAGO, a national banking association,

Appellee.

APPELLANTS' REPLY TO APPELLEE'S SUPPLEMENTAL BRIEF.

SAMUEL B. STEWART, JR.,

G. D. SCHILLING,

300 Montgomery Street, San Francisco 4, California,

MORSE ERSKINE,

ERSKINE, ERSKINE & TULLEY,

625 Market Street, San Francisco 5, California,

Attorneys for Appellants.

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APPELLANTS' REPLY TO APPELLEE'S SUPPLEMENTAL BRIEF.

1. BANK OF AMERICA DOES NOT BASE ITS CASE ON LOFENDO'S RIGHTS.

Merchandise says that Lofendo "was United Produce"; that "United Produce had no rights arising out of the 6 or the 4 checks, because of the fraud"; and that Bank of America "rests its case on 'Lofendo's' rights" (MSB, 6-7).[1]

Merchandise makes this argument as though Bank of America was an assignee of Lofendo or United and was

[1] "MSB" stands for Merchandise's supplemental brief, and "MRB" for its reply brief.

seeking to enforce the rights of either of them against Merchandise. But this is not the case at all. The fact is that when Merchandise charged United's account, marked the checks paid, credited Bank of America and sent Bank of America the advices of credit, the checks were paid and Bank of America received the proceeds of their payment, that is the credits, and Bank of America became indebted to Lofendo in the amount of the payments. Bank of America is not suing Merchandise to enforce any rights of Lofendo, but Merchandise is suing Bank of America to recover its payments of the checks. Bank of America does not base its rights to retain these payments on Lofendo in any way whatever.

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2. MERCHANDISE'S ARGUMENT THAT IT DID NOT PAY THE CHECKS BUT ONLY BECAME OBLIGATED TO PAY THEM IS ENTIRELY UNJUSTIFIED.

Merchandise argues that when Bank of America says that the checks were paid, it means that Merchandise "became obligated to pay them" and in effect accepted them (MSB, 4).

"Payment is the final act which extinguishes a bill. Acceptance is a promise to pay in the future and continues the life of a bill"; *State Bank of Chicago v. Mid-City Trust and Savings Bank,* 293 Ill. 599, 120 N.E. 499, cited on page 5 of our reply brief.

When Merchandise charged the checks against United's account, marked them paid, credited Bank of America and sent Bank of America the advices of credit stating that the checks were paid and Bank of America had been credited, the checks were paid and extinguished and were not accepted and did not continue alive. Merchandise was not then obligated to pay them; it had paid them.

Any other conclusion would make havoc in the banking business.

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3. THE CREDITS GRANTED BY MERCHANDISE WERE THE PROCEEDS OF THE CHECKS.

Merchandise says that Bank of America is in error when it refers to the "proceeds" of the 4 and 6 checks; that in this case "no funds were collected" and "there were no proceeds" (MSB, 5).

The collection letters directed that the "proceeds" of the checks be disposed of by crediting Bank of America. The credits were the proceeds. What other term could one use to describe what was obtained for the checks?

In making this contention, counsel for Merchandise seems to be laboring under the misconception that banks pay one another by transmitting bags of coin or currency. Of course, they don't. They pay by drafts and credits; by bookkeeping entries. And this is true whether or not they maintain deposit accounts with each other. Inter-bank deposit relations are characterized by this important difference from ordinary bank-customer deposit relations. The credits granted by Merchandise were not only the "proceeds" contemplated by the collection letter; they were the only proceeds to which the checks gave rise.

Merchandise tries to brush off *Commercial National Bank v. Armstrong,* 148 U.S. 50, 13 S.Ct. 532, cited on pages 26-27 of our closing brief, by stating that in it "the New York rule governed" (MSB, 2). The statement is totally irrelevant. In the *Commercial National Bank* case the court held that where the collecting-drawee banks to which the forwarding bank was indebted credited the forwarding bank on account of such indebtedness with the amount of the checks, the funds were thereupon transmitted to the forwarding bank. This would have been the

result whether the New York or Massachusetts rule was applicable. It was entirely unnecessary for the court to refer and the court did not refer to either of these rules.

When Merchandise (the collecting-drawee bank) credited Bank of America (the forwarding bank) on account of Bank of America's indebtedness to Merchandise with the amount of the checks, the funds, as held in the *Commercial National Bank* case, were thereupon transmitted to Bank of America; or to paraphrase the language of that case "the collection had been fully completed"; "it was the same as though the money had actually reached the vaults of" Bank of America.

And we should add that the *Commercial National Bank* case is followed by an authority which is important in this argument, a decision of the Supreme Court of Illinois where the Massachusetts rule prevails, that is *People ex rel. Nelson v. Sheridan Trust and Savings Bank*, 353 Ill. 290, 193 N.E. 186, cited on page 34 of our opening brief.

Merchandise says that United "had no funds to its account", and Lofendo "could not have compelled plaintiff to honor the checks" (MSB, 5).

United did have funds to its account, that is the proceeds of loans made by Merchandise to United which Merchandise had not disaffirmed and against which it had not exercised its right of set off (OB, 22-28).[2] But whether this be so or not Merchandise paid the checks and the credits it granted Bank of America represented the proceeds of the payment.

The fact that Lofendo could not have compelled Merchandise to honor the checks is, of course, entirely irrelevant. Merchandise did honor them.

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[2] "OB" stands for Bank of America's opening brief, and "RB" for its reply brief.

United could not have compelled the branch to honor the checks for $109,000.00. But when the branch charged these checks against uncollected funds it did honor them as Merchandise states repeatedly in its brief.

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4. SECTION 16c OF THE CALIFORNIA BANK ACT AUTHORIZED BANK OF AMERICA TO ACCEPT CREDITS FROM MERCHANDISE IN PAYMENT OF THE CHECKS.

Merchandise now says that the question, whether section 16c of the California Bank Act authorized the forwarding bank or the collecting bank to designate the bank the credit of which may be accepted in payment, is "irrelevant" (MSB, 10). This is inconsistent with Merchandise's previous arguments (MRB, 58-59, 89-90, and footnote 45, p. 90).

But Merchandise nevertheless persists in saying that "a credit on plaintiff's books was not one" of the modes of payment authorized by section 16c (MSB, 10). The basis of this contention is that section 16c provides that a forwarding bank may accept in payment of a check a "solvent credit on the books of any Federal Reserve Bank or on the books of any bank designated as a depositary by" the forwarding bank. Merchandise says that Merchandise had not been designated as a depositary by Bank of America because Bank of America had not previously had a bank account with it on which Bank of America could draw to pay its obligations similar to the bank account maintained by Merchandise with Bank of America. But when Bank of America stated in the collection letters that Merchandise should deliver the checks only on payment and that Merchandise should dispose of the proceeds of the checks by crediting Bank of America, Bank of America was saying that it would accept a credit with Merchandise in payment of the checks. In

other words *Bank of America then and thereby designated Merchandise as a depositary* of those funds. What other meaning could the collection letters have? And when Merchandise entered the credits on its books in favor of Bank of America Merchandise in fact became a depositary, that is it owed Bank of America the credits. And the fact that Bank of America did not have an ordinary bank account with Merchandise does not militate in the slightest against this conclusion.

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5. BANK OF AMERICA WAS IN THE POSITION OF A BONA FIDE PURCHASER FOR VALUE.

Merchandise in discussing Bank of America's claim that it was in the position of a bona fide purchaser of a right of set off asks "who owned a right of set off which defendant bought?;" and again it asks "and what is being set off against what?" (MSB, 5-6).

Bank of America made it clear that it held a lien on the proceeds of the checks and was therefore a holder for value under section 3108 of the California Civil Code. The fact that Lofendo became indebted to Bank of America a day or so after Merchandise paid the checks rather than a day or so before could not deprive it of this status (OB, 45-51; RB, 41-42).

Bank of America also made it clear that if it be assumed that it was not such a holder, still it was in the position of a bona fide purchaser of a right of set off (OB, 51-53; RB, 41-46).

At the close of business on November 16th, before Messenger's telephone call of November 17th putting Bank of America on notice that Merchandise was claiming that it had paid the six checks by mistake, Lofendo was entitled to the credit for the 4 and 6 checks and was

indebted to Bank of America because of its payment of the checks for $109,000 and $75,000. On that day Bank of America had a right (a right "in the nature of a lien")[3] to set off Lofendo's indebtedness to it against the credits. It did not buy the right from anyone; it acquired the right under the law. And it was in the position of a bona fide purchaser of the right just as though it had taken a mortgage of property to secure an indebtedness to it before receiving notice that the mortgagor had obtained the property by fraud (OB, 51-53).

Moreover Merchandise is in no position to question Bank of America's right to offset its payments of the $184,000 (the checks for $109,000 and $75,000) against the credits because $161,000 of these payments was received by Merchandise and applied by Merchandise on account of United's indebtedness to it (OB, 54-56. BB, 46).

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6. MERCHANDISE'S NEGLIGENCE PLUS BANK OF AMERICA'S PREJUDICE IS A DEFENSE.

Merchandise says that Bank of America asserts "that negligence plus prejudice to the other party is a bar" (MSB, 11).[4] And then it says: "But the kind of prejudice required by the law is prejudice resulting from change of position by the recipient in reliance on the payment" (MSB, 11).

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[3]In the *Gonsalves* case, 16 Cal. 2d 169, 105 P. 2d 118 (OB, 48-49), the court said that the right of a bank to charge what it owes its depositor with indebtedness owing by him to it is more correctly called "a right of set off" rather than a lien, but that it is "in the nature of a lien or security interest in the funds" (OB, 48-49).

[4]On page 70 of its reply brief it misstated Bank of America's contention by saying that Bank of America argued that a payor cannot recover on the ground of mistake if the mistake was due to his negligence. Now it appears willing to correct its error.

This narrow view of the law is not sound. An action to recover a payment made by mistake is an equitable action. If a payor's mistake in making a payment was due to his negligence and the payee will suffer no prejudice as a result of such negligence if the payor recovers, then there is no equitable reason to bar the payor's recovery. But if the payee will suffer prejudice as a result of such negligence if payor is permitted to recover, then in equity and good conscience the payor should not recover.

This is the law as stated in 40 Am. Jur. 848 and sec. 142 of the Restatement of Restitution, cited and quoted from on pages 103-104 of our opening brief.

We quote an additional extract from this section of the Restatement:

> "The rule stated in this Section is an application of the underlying principle of this subject that restitution is granted only where it is equitable so to do. Where events are such that a loss must be suffered by one of the parties, either with or without the ability to obtain reimbursement from a third person, justice does not require that the recipient should bear this loss, where he is guilty of no greater fault than that of the claimant." (p. 568.)

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7. BANK OF AMERICA MADE AN "ACTUAL APPLICATION" OF THE CREDIT FOR THE 4 CHECKS TO THE PAYMENT OF THE CHECKS FOR $75,000.00.

Merchandise says that Bank of America did not enter a charge for the four checks against Merchandise's account at its head office until November 19th after it had received notice in the Messenger Estribou telephone conversation of November 17th that Merchandise had paid the six checks in error; and that Bank of America "*never mentions this charge at all*" (Merch's italics; MSB, 8-9).

This statement is not correct. Bank of America does mention the entry of this charge on page 47 of its reply brief, pointing out that Merchandise's contention respecting it is another illustration of its fundamental fallacy that the checks were not collected and paid until Bank of America entered a charge against Merchandise on its books at its head office.

Merchandise also says that in any event the branch did not post the credit for the four checks until November 18th after the telephone conversation of the 17th (MSB, 8-9). The advices of credit for the four checks were received at the Branch on November 16th (I, 1182). It was stipulated that counter work, such as the credit for the four checks, was posted "on the next business day after the day *on which they were handled,* but the posting appeared under the day on which they were *actually handled"* (III, 960-961);[5] and also that on November 17th the checks for $75,000 were put in the counter work and the $89,000 was "credited to the account" on November 17th and posted on the 18th and "concurrently the checks for $75,586.86 were charged against the new funds" (IV, 1181, 1183).

Bank of America and Merchandise followed the same practice so far as delayed posting of counter work is concerned (III, 961). Merchandise's handling of the four and six checks illustrates the use of this method of delayed posting. When the six checks were received at Merchandise on November 15th, Merchandise on that day stamped the checks "Paid November 15, 1948" and mailed the advices of credit to Bank of America; and on the next day, November 16th, it pursuant to the practice of delayed posting entered on its books a charge against

[5]Merchandise in referring to this stipulation says that it appears on page 861 of the record (MSB, 9). The citation is incorrect. The correct citation is given in the text.

United's account as of November 15th and a credit in favor of Bank of America as of November 15th (IV, 1176; I, 289-294). It "handled" the checks on the 15th and made the postings on the 16th as of the 15th. In exactly the same way Bank of America on November 17th handled the credit for the four checks and the charge against this credit of the checks for $75,586.86; and posted the entries on November 18th as of November 17th.

The facts must control the rights of the parties in this case, not as Merchandise repeatedly asserts the making of bookkeeping entries.

If Bank of America in order to bring its case within the rule of *Weiner v. Roof* must show what Merchandise calls "an actual application" of the credit for the four checks to the payment of the checks for $75,586.86 (Bank of America, of course, does not concede this proposition), the stipulated facts of this case show such an application.

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8. BANK OF AMERICA DOES NOT IGNORE THIS CASE OR THE FINDINGS.

Merchandise's statement, that Bank of America ignores the case and the findings (MSB, 1) is preposterous.

Bank of America has faced the decisive issues in this case fairly and squarely. And with two exceptions, these issues must be decided on the basis of stipulated facts or facts established without conflict. For example, the issue whether the checks were paid must be decided on the basis of such facts; and the trial court's finding that they were not paid is erroneous because contrary to such facts and the law. The same is true of the other issues with the two exceptions we have mentioned. These two exceptions are the findings (1) that Bank of America was negligent in not discovering the kite and (2) that

Bank of America agreed to repay Merchandise the latter's payment of the six checks.

Bank of America argued the question whether the latter finding is supported by the evidence on the basis of Merchandise's own evidence (OB, 107-117). And it pointed out that the former finding is not supported by the evidence (OB, 89-95); but that if it be assumed that it is so supported, it does not help Merchandise because Merchandise's gross negligence is the primary cause of the loss and because the law will leave the loss where the parties have placed it (OB, 103-106; RB, 55-57).

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March 24, 1952.

Respectfully submitted,
SAMUEL B. STEWART, JR.,
G. D. SCHILLING,
MORSE ERSKINE,
ERSKINE, ERSKINE & TULLEY,
Attorneys for Appellants.